

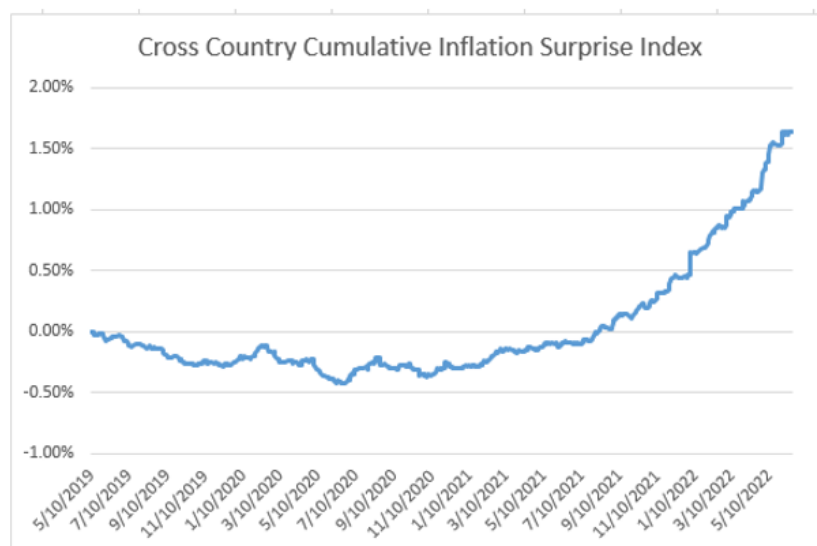
# Inflation Surprise: EM Is No Worse and Sometimes Better Than Developed Markets

By: Federico Sequeda, CFA | & Chris Loger | June 29, 2022

The growth in inflation that has dominated the financial world over the past 18 months caught many economists and investors by surprise, as common perceptions of the surge have progressed from "transitory" to something more durable—although how durable is still very much up for debate. A related, major consideration for investors concerns how well inflation is being managed and contained in both developed and emerging markets countries.

The global, combined "inflation surprise" chart below adds some statistical validation to the perceptions. The vertical axis shows the degree to which actual inflation levels exceeded the average amount expected by surveyed economists, measured daily, and cumulative through June 21, 2022. While the surprises were underwhelming for the first two years after May 2019, the chart shows a dramatic uptick over the past year or so, as inflation increasingly exceeded expectations.

## Inflation Growth Has Exceeded Expectations...

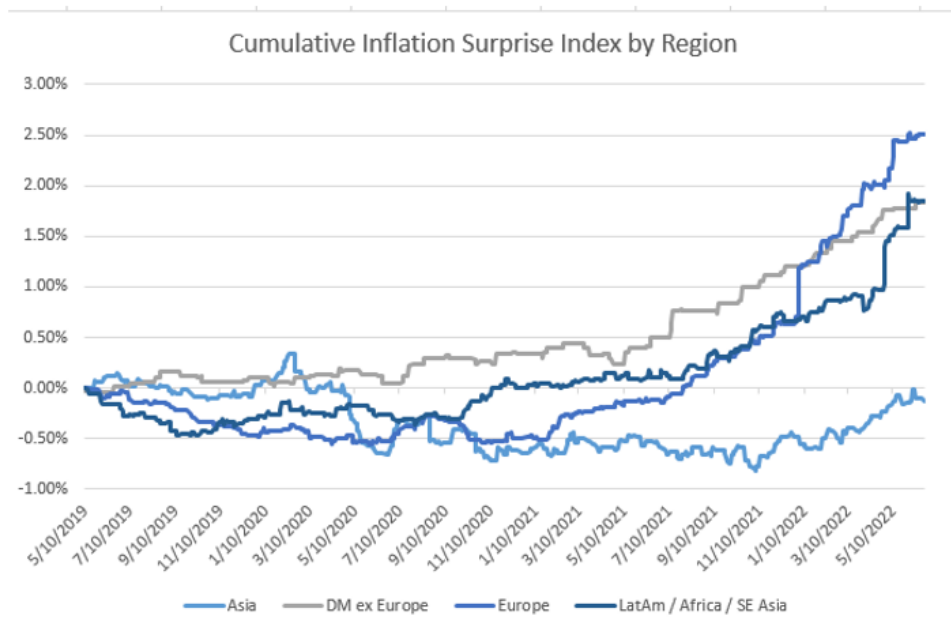


Sources: Bloomberg LLC, Morgan Stanley Investment Management, 6/21/22.

For emerging markets, the topic of inflation comes with a lot of historical baggage. In the past, hyperinflation has hit Brazil, Argentina and Bolivia, and more recently, Zimbabwe and Venezuela. It's easy to see why such episodes create lasting impressions-and generalizations-that are reinforced by poor central bank policies and currency depreciation that were common historically in emerging markets.

From that perspective, the next chart carries another surprise: Developed markets are experiencing just as much inflation, if not more, than emerging markets, depending on the region. It is the same data set as above, broken out by region.

## ... But Developed and Emerging Markets Are Surprisingly Comparable



Sources: Bloomberg LLC, Morgan Stanley Investment Management, 6/21/22.

Most notably, Asian inflation surprises have mostly been to the downside and just recently, are breaking even. Europe leads the pack in terms of the biggest inflation surprises, while the rest of the developed world is on a par with Latin America/Africa/and SE Asia.

The broad factors driving inflation have been well publicized, from the Russia/Ukraine war's influence on gas and grain prices to supply chain issues in China. But some countries have been better at adapting to the new environment. For example, compared with developed countries, we believe Chile and Uruguay have been better at managing inflation growth.

These inflation observations underscore a key trend we have witnessed in emerging markets in recent years: Investors are no longer viewing the sector monolithically. Even under stressed conditions, investors increasingly are differentiating among countries based on the fundamentals. In that light, inflation is just one more factor in country analysis.

**Bottom line:** The new inflationary environment underscores the need for proprietary due diligence in emerging markets—an approach that focuses on country-level macroeconomic and political research and stand-alone analysis of specific risk factors. It has been our philosophy for more than two decades and is especially relevant today.



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